

No. 9220

IN THE
United States
Circuit Court of Appeals

FOR THE NINTH CIRCUIT,

UNITED STATES OF AMERICA, acting for and in
behalf of the Farm Credit Administration,
Appellant,

vs.

J. A. BURLEIGH, *Appellee.*

BRIEF OF AMICI CURIAE

*Upon Appeal from the District Court of the United
States for the District of Oregon*

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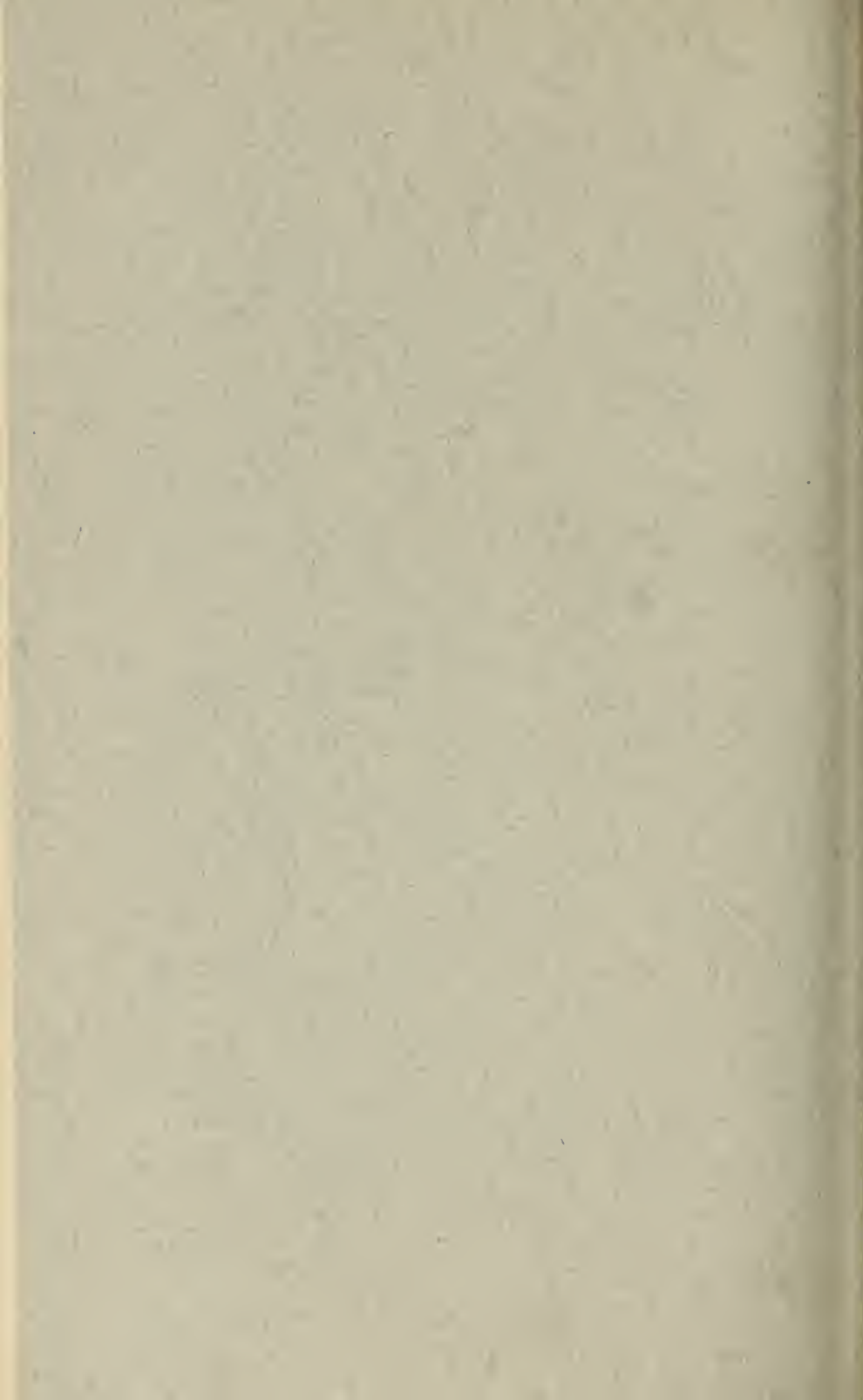
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ARGUMENT

INTRODUCTION

On behalf of the Federal Intermediate Credit Bank of Spokane the undersigned have asked leave to file a brief amici curiae in this case. The bank has no financial interest in the outcome of this suit. It would not be otherwise concerned were it not for certain findings of fact and certain statements

in the published opinion of the Honorable District Court which assume that the bank was connected with the transaction upon which the cause of action was based and which reflect upon its good faith in that connection. In brief, the Court found that the note here sued upon was induced by representations made by officers of the Agricultural & Livestock Credit Corporation; that the Federal Intermediate Credit Bank was, through the medium of some sort of conspiracy, a party to the representations; and that the representations were false.

The record seems to us devoid of any evidence upon which the Court could have found that the bank was in any way connected with the transaction, or responsible for any representations that may have been made to induce it; and we think the evidence overwhelmingly shows that the representations which the Court found were made by the loan company regarding its financial condition were not only believed by it to be true but were, in fact, true. It is our purpose in this brief to analyze the evidence in some detail, in support of these assertions and of appellant's assignments of error as designated in its statement of points (R. 414-416).

The particular assignments to be discussed herein are those of error in denying paragraph VIII of

appellant's requested findings (R. 68) and in making findings number IX, X, XI, XII, and XIII (R. 106-110, Appellant's brief, page 10).

HISTORY OF TRANSACTION

The action is brought against the appellee to collect a note given by him in renewal of a note of date April 15, 1931, payable to the Secretary of Agriculture of the United States in the sum of \$1000.00 to finance the purchase of capital stock of the loan company above named. The note evidenced a loan under the Act of Congress known as Public No. 666, 71st Congress, approved February 14, 1931. The text of the Act is set out at pages 352, 353, of the transcript of the record filed herein.

The facts are set out in appellant's brief and need not be amplified here, except to recall the economic situation which led to the enactment of Public No. 666.

Following the financial crisis of 1929, credit for agricultural products had been sharply restricted. Market prices of livestock and other agricultural products had fallen, but not to an alarming extent. The index number (based on 1909 to 1914=100) of farm prices of meat animals still stood at 111 in January, 1931, and the average of farm prices on

all groups of produce stood at 101 ("Livestock Meats and Wool Market Statistics and Related Data, 1938," published by Bureau of Agricultural Economics, May, 1939, p. 71). Livestock lending agencies, in general, could have liquidated the loans of their borrowers without loss to the companies. However, to do this would have caused a sacrifice on the part of borrowers of values still expected to return within a reasonable time and would have forced many of the farmers and stockmen out of business. Forced liquidation would have seriously crippled the livestock industry and maintenance and expansion of credit facilities were essential to tide over the depression, which was thought to be as temporary as like recessions in the past had been.

Regional Agricultural Credit Corporations had not yet been established and were not to come into existence until July, 1932. The only sources of credit for livestock operations, in general, were local banks and agricultural credit corporations or livestock loan companies authorized to discount with the Federal Intermediate Credit Banks. Bank failures in 1930 had more than doubled over the number of suspensions in each of the three preceding years (17 Federal Reserve Bulletin, 1931, p. 47). The Federal Intermediate Credit Banks had been established under the

act of March 4, 1923 (12 U. S. C. Sections 1021 et seq.) and already had purchased or discounted during the less than eight years of their existence more than a billion dollars of agricultural paper. On December 31, 1930, they had outstanding loans and discounts to livestock companies throughout the nation of approximately 33 million dollars. These banks were, however, limited by the law to loans or discounts to any such lending institution to an amount not exceeding ten times the paid-in unimpaired capital and surplus of such a corporation (12 U. S. C. Section 1032). The Farm Loan Board was empowered to and did make such rules and regulations as it deemed necessary for carrying out the law (12 U. S. C. Sec. 1101). By its regulations it excluded long term real estate loans and other non-liquid securities from the definition of unimpaired capital. It also authorized the Intermediate Credit Banks to exercise discretion as to whether they would loan or discount to a given corporation an amount equaling the maximum permitted by law (Appendix A, *infra* p. 40). As a matter of practice, the maximum generally loaned to or discounted for any company did not exceed seven times its unimpaired capital and surplus (R. 345). Only by keeping their collateral in liquid condition and with adequate margin were

these banks enabled to sell their debentures, from which their loans were made, at the then unprecedented interest rate of 3%.

Public No. 666 provided for the making of loans to individuals to assist them in forming agricultural credit or livestock loan companies or for increasing the capital stock of such companies already existing and qualified or to be qualified to do business with the Intermediate Credit Banks. This would enable such companies to maintain and perhaps expand the lines of credit theretofore enjoyed from the Intermediate Credit Banks.

The Agricultural and Livestock Credit Corporation of Portland was one of such companies. To it the Federal Intermediate Credit Bank of Spokane had extended credits by rediscounts amounting to about \$635,000. To maintain this credit it should have a capital of \$63,500, not less liquid than livestock loans. Some of its capital had become real estate mortgages or real estate owned. The Corporation sought to avail itself of the benefits of the act by interesting friends of the livestock industry, including its own customers, in the purchase of preferred stock in the company, to be paid for by loans made to such purchasers by the Secretary of Agriculture. Succeeding in this, it could continue to carry its bor-

rowers by renewals which could continue to be rediscouted at the Federal Intermediate Credit Bank, and could hope to extend its service to other operators. Its earning capacity of 3% per annum (the spread between the bank's interest rate and that charged by the company, Appendix A, *infra* p. 43) on its total volume of loans would seem to promise a reasonable profit to its stockholders. Among those purchasing such stock and borrowing the money to pay for it under the terms of the act was the appellee, who executed to the Secretary of Agriculture the note sued upon.

DISCUSSION OF DEFENDANT'S THEORY

The appellee in effect alleged as a defense that he was induced to execute the note upon false representations made by the officers of the Corporation, with the connivance of the plaintiff, to the effect that the company was solvent and the stock being purchased by him was worth par, that it would be a good investment, that dividends would be paid equaling the interest, that the stock would be retired and its proceeds used to pay the note, and that he would not be required to pay it; whereas, as he alleged, the Corporation was insolvent and the stock, to appellant's knowledge, was not worth anything.

Appellee offered no evidence tending to show that the Secretary of Agriculture knew anything regarding the financial condition of the Corporation beyond the facts set out in its financial statement which was attached to and made a part of the appellee's application for the loan and thereby vouched for by him as correct. This was not introduced in evidence, but its submission with the application is recited therein (R. 129) and presumably was approximately the same as the company's statement of March 31, 1931 (Appellee's Ex. 20, R. 286) which showed capital intact and a substantial surplus. For lack of evidence or fact to support the allegation that the Secretary had knowledge that the stock of the Corporation was worth less than its par value, appellee argues that, since the capital stock of the Federal Intermediate Credit Bank is owned by the United States and since the Secretary of Agriculture is an officer of the United States, knowledge had by one is imputed to the other and to the appellant, and that the Secretary and, therefore, appellant is chargeable with knowledge of facts known to the Intermediate Credit Bank through its periodical examinations. Such a proposition is obviously untenable.

Furthermore, it seems clear that the Secretary of

Agriculture would not have deliberately loaned funds for investment in worthless stock. He was not authorized to give away the money in his hands. He was authorized only to loan, with all that implies. In his own regulations he required that the stock purchased by subscribers be pledged with him for repayment of the loan (R. 350, 370). Should the security be impaired, additional collateral must be given (R. 373). It was never required in this case. Regardless of whether Mr. Burleigh's personal financial responsibility was as worthless as he himself contends (Appellee's brief, pp. 4-5), it can be certain that the Secretary of Agriculture considered the additional collateral of the stock in the loan companies to be valuable and necessary collateral. It is inconceivable that the Secretary would have accepted the stock as collateral if he thought it was worth less than 100 cents on the dollar, thereby stultifying himself under his own regulations and violating the elementary principles of good faith required of a trustee. To contend that he did so seems utterly unreasonable.

Nor could appellee produce any evidence tending to show that either the bank or the Secretary of Agriculture had any part whatsoever in the sale of the stock by the Corporation, or authorized or knew of any representations, false or otherwise, made by anyone to induce the appellee or others to purchase

such stock. To overcome this lack of evidence and of fact, the appellee, in effect, alleged a conspiracy between the Secretary of Agriculture, or his agents, and the Federal Intermediate Credit Bank, and the Corporation, under which the Corporation was to sell its stock (R. 31); and specifically alleged that the appellant, through its agents, conceived a plan and scheme with the Corporation that the latter should sell its stock following the representations above mentioned and alleged to be false, and that the whole plan was devised to benefit the United States. Attempting to show that these transactions were to benefit the United States, appellee seizes upon the fact that the capital of such loaning companies is pledged with the discounting Federal Intermediate Credit Bank (Rules and Regulations, Appendix A, p. 42), and argues that since the stock of such banks is owned by the United States the whole arrangement was a device for improving the collateral position of such banks (Appellee's brief, pp. 40-41). As to the "plan" alleged under which representations made by the company in obtaining stock subscriptions are sought to be chargeable to the appellant, there is neither evidence nor argument in appellee's brief other than that the circular issued by the Department of Agriculture set forth a plan under which subscribers for stock in such corpora-

tions might obtain through the Secretary of Agriculture the funds to pay for it. This circular is set out in full in the record (R. 345-373), and is quoted from at pages 26-28 of appellee's brief. Appellee does not contend, either in the evidence introduced or in his argument, that there was any actual specific agreement between the Secretary of Agriculture, the Federal Intermediate Credit Bank and the Agricultural & Livestock Credit Corporation whereby the Corporation was to solicit subscriptions or make any representation to subscribers. The "plan" relied on by appellee throughout is the general plan initiated by Congress and developed through general instructions of the Secretary of Agriculture. This is made more clear by the testimony of appellee himself in his attempted explanation of his contention on direct examination (R. 182-183) and cross examination (R. 190-198, 333, 336).

The whole theory of appellee on its face seems too fantastic to have justified it being taken seriously by the Court. The note was given to the Secretary of Agriculture on behalf of the United States. The entire capital stock of the Federal Intermediate Credit Bank, it is true, is owned by the United States, having been subscribed and being held by the Secretary of the Treasury; but the bank is not a

department of the Government. It is a separate corporate entity. The bulk of the money it loans is not public funds but is obtained from private investors through the sale of its debentures, as security for which it pledges notes and collateral obtained by discount, or as collateral to direct notes, from various types of agricultural lending organizations. These debentures are not obligations of the government, direct or indirect (12 U. S. C., Sec. 1043). At the time the notes here involved were executed, the Intermediate Credit Banks were under the supervision of the Federal Farm Loan Board, of which the Secretary of the Treasury was the ex-officio chairman, and the banks were in no respect under the supervision of the Secretary of Agriculture, nor was he in any respect responsible for their operation. By Executive Order of the President on March 27, 1933, the functions of the Secretary of Agriculture in connection with such loans as are here involved were transferred to the newly formed Farm Credit Administration, as were those of the Federal Farm Loan Board, including those of the Secretary of the Treasury in that connection. Not until 1939 did the Secretary of Agriculture have any connection with the Farm Credit Administration or the Federal Intermediate Credit Banks. It is quite unthinkable that any Secretary of Agriculture or his agents would have conspired with a private

corporation for the fraudulent sale to a private citizen of its stock for the purpose of benefiting some agency for which the Secretary was responsible. To extend such venality to acts calculated to benefit some corporation for whose success or failure he was in nowise responsible, seems beyond the reach of any ordinary imagination.

FINDINGS BY COURT

However, the Court found with the defendant on this incredible defense. He found (R. 104) that the United States, acting through the Secretary of Agriculture and his representatives, and acting by and through the Federal Intermediate Credit Bank of Spokane, entered into a plan and device with the Agricultural & Livestock Credit Corporation, having for its purpose the improvement of the financial condition of the Corporation and thereby improving the position of the Federal Intermediate Credit Bank; that pursuant to such plan, representations were made to appellee that the stock was worth its par value or more and was and would be a good and desirable investment.

He found in particular that at the time of the transaction at least \$50,000 of the supposed capital of the Corporation was valueless and that, in addi-

tion thereto, it carried as assets notes and other properties worth substantially less than the amount at which they were carried, with the result that at the time it was proposed to sell said Class A stock to appellee it was worth practically nothing and is now of practically no value (Finding No. XI, R. 106).

In his memorandum opinion (R. 70-75) reported in 26 Fed. Sup. 938, he mellows these findings as to the appellant and the bank by stating that no criticism is intended of the motives of the Government officials and that they were merely carrying out the declared policy of Congress, but that both the Department of Agriculture and the bank knew or should have realized that an investment in the stock of the loan company at that particular time was not a sound investment. The vice charged to the Secretary of Agriculture and the Credit Bank in the opinion is that "they stood by and permitted the sale of stock which to their definite knowledge was then of doubtful value,—stock which has since turned out to have little or no value."

ANALYSIS OF EVIDENCE

We agree entirely with the theory of appellant in its brief that the record is not such that any burden devolves upon it to show the truth of the

alleged representations; but we think it may be of assistance to the Court in reviewing the whole case if we analyze the evidence upon which the findings, particularly finding No. XI above referred to, are based. While we submit this analysis primarily to negative the inference which the Court drew from the evidence, that the Federal Intermediate Credit Bank of Spokane "stood by and permitted the sale of stock which to their definite knowledge was then of doubtful value" for its own benefit, yet it equally shows, we think, that, regardless of the considerations hereinabove discussed, the judgment against appellant cannot be sustained.

The Court bases his findings that the stock of the Corporation was worthless, that at least \$50,000 of the supposed capital of the company was then valueless and that, in addition thereto, it carried as assets notes and other properties worth substantially less than the amount at which they were carried, upon the report to the Federal Intermediate Credit Bank by its examiner of the affairs of the Corporation (R. 214-220), following an examination as at the close of business on April 25, 1931, and upon a letter of criticism addressed to the Corporation by the bank on May 11, 1931 (R. 208-213), which we think affirmatively disprove the finding; and upon the fact

that during the succeeding *seven years* up to and including 1938 there was charged off some \$90,000 of the assets of the company, his conclusion from which, in view of the disastrous years of 1932, 1933, and 1934, is an obvious non sequitur.

The examiner's report in full was not introduced in evidence. It appears, however, that at that time (R. 208) the loans and discounts of the company aggregated \$702,493.54; that (R. 209) some \$369,000 of these were classified by the bank's examiner as good, some \$296,000 were classified as fair, and some \$37,000 classified as doubtful. The portion of the examiner's report introduced in evidence (R. 214-220) consisted only of the schedule of loans and other items subject to criticism. The analysis in this schedule is very complete. Columns are provided for "Good," "Fair," "Doubtful," and "Loss." All of the items listed are classified as at least "Fair" except four which were classified as "Doubtful." None were classified in the "Loss" column. The examiner's marginal remarks as to three of the "Doubtful" items indicate a partial prospective loss. As to the fourth, "John Hartles, \$6205.14" (R. 216) the remarks show an actual profit since the company had taken over the security for this loan valued by the examiner at \$6700.00. It was not properly "Doubt-

ful" but should have been, as the examiner remarked, included in "Inventory" rather than "Loans." Of the three remaining "Doubtful" items, the first is a real estate mortgage, Curtice Farms, Inc., of which the entire \$36,797.28 is placed in the "Doubtful" column (R. 219); but the marginal note shows definitely that this is not regarded as a prospective loss except in part. The security consisted of 311 acres of land subject to mortgages aggregating \$23,100, with an estimated value of \$50,000, or an estimated loss of some \$9900.00. The next item classified as "Doubtful" was a third mortgage for \$3933.31, Max Schmidt, on some 3000 acres of land subject to a prior mortgage of \$13,500, and the examiner's remark states "land probably not worth value" (R. 219). The last item classed as "Doubtful" (R. 220) consisted of 280 acres of Jackson County land carried at \$4000.00, valued by a disinterested party at \$4000.00 but appraised at \$1,400.00, which valuation is doubted by the examiner.

As a result of the examiner's report and the letter of criticism (Defendant's Ex. 12, R. 93-100) there was immediately charged off all the prospective losses indicated thereby as follows: on the Curtice Farms item \$11,174.46, on the Schmidt item \$1933.31, and on the real estate item \$2000.00 (R. 392-394). *These*

charge-offs left the company's capital still intact and \$21,000 of earned surplus and \$1209.50 undivided profits still in its capital accounts (R. 291).

No other prospective losses were indicated by the report, as an examination of it will show.

We may assume that if a loss were expected on any item such items would in whole or in part appear in the "Loss" column; that an item would be placed in the "Doubtful" column if a reasonable doubt existed as to its entire collectibility in the ordinary course of business; and that an item would be placed in the "Fair" column if it was reasonably believed to be collectible in due course if given reasonable supervision and attention. The "Fair" classification is better described in the October, 1931, examiner's report (R. 233) where the word "slow" is substituted for it. Had a witness been called as to the practices of such examiners in classifying assets for Federal Intermediate Credit Banks, the evidence would have sustained these definitions; and a comparison of the remarks of the examiner with his classification bears out this statement. The Corporation's loans were all upon cattle or sheep and the examiner's remarks show the number of head and the amount loaned per head. No evidence was introduced as to the relation of these loan values to the

market value of the security. However, we are furnished some evidence in this connection by appellee's own statement of values of such property in his financial statement accompanying his application for the loan (R. 150). That statement shows the values of his own cattle, ranging from \$40.00 to \$100.00 per head and his own valuation of sheep at \$8.00 per head. An examination of the examiner's remarks as to each loan shows that in only six cases did the loan value on cattle of borrowers exceed the minimum value of \$40.00 placed by appellee on his own cattle. These were Brons (R. 214), Butler (R. 214), Heitman (R. 215), Kingrey (R. 215), Long & Paulsen (R. 215), and Decker (R. 216) whose loans aggregated less than \$10,000, and upon which no losses appear in the subsequent charge-offs. In no case of sheep loans did the amount loaned per head equal \$8.00, which was appellee's valuation of his own band of sheep of which 40% were aged (R. 217).

The Court apparently relied chiefly, in reaching his determination, upon the letter of criticism from the Federal Intermediate Credit Bank relating to the examiner's report, quoted at length in the findings (R. 93-100), and shown in full as Defendant's Exhibit 12 (R. 208-213). No witness was called to explain this letter. In it Mr. Meyer (R. 93) sum-

marized the four items classed as "Doubtful," which we have referred to in detail, as *non-liquid in character*, and subtracted them from the total capital, surplus, undivided profits and reserve accounts, leaving, as he stated, a net "unimpaired" capital and surplus of \$47,907.58. We think it must have been the Court's misconstruction of this letter which led him to find that the stock of the company was at that time without value. But in Intermediate Credit Bank examinations the term "capital impairment" does not relate to values but to liquidity. We think the Court will take judicial notice of regulations of the Treasury Department, issued as Circular No. 15 in 1925, which were the regulations then in force. The following is quoted from page 14 of that circular (See Appendix A, *infra* p. 41).

"Non liquid capital investment.

Investment of the capital of a rediscounting agency in stock of an industrial corporation, office building, *long term real estate loans*, or *other non-liquid securities* restricts the ability of the rediscounting agency to indemnify the bank upon its endorsement liability. Where the capital of a rediscounting agency is so invested, the bank should consider it as being impaired to such extent as may be disclosed by careful investigation."

The explanation for this is that the Credit Banks were by law limited to discounting livestock and agri-

cultural paper having a term of not over three years (12 U. S. C. Sec. 1033), corresponding to the longest period considered necessary for raising animals to a marketable age. The regulations thus directed real estate and real estate mortgages to be deducted as impaired capital from the assets of a discounting institution in determining the amount of capital available as a basis for discounting operations. All the items (except Hartles, which we have seen was more than fully secured) which Mr. Meyer directed be deducted from the company's assets in determining its unimpaired capital for discounting purposes consisted of real estate mortgages and real estate. That the question of valuation of these assets did not enter into the criticism is made clear by Mr. Meyer's letter, written five days later, May 16, 1931, and introduced as Defendant's Exhibit 16 (R. 241-243) tacitly approving the charge-off of items therein stated and later made (R. 391-394) to which we have already referred. As we have seen, *Supra*, pp. 21, 22), the items charged off consist of the then prospective losses on the three real estate items hereinabove mentioned, and after having been charged off left the Corporation with its capital intact and with \$21,585.64 of earned surplus, as is shown by Exhibit 16 and the company's financial statement. In the statement of April 30, 1931 (R.

288) this charge-off had not been made and the statement showed a surplus of \$25,000, reserve for losses \$10,950, and undivided profits of \$851.59. The charge-off was actually made on the books prior to the May 29, 1931, statement (R. 289, 290), although apparently not approved by the directors until the June meeting. After the charge-off the statement of the company as of June 30, 1931 (R. 291) still shows a surplus of \$21,000, undivided profits of \$1,209.50, and capital intact.

A discrepancy in respect to the amount of outstanding capital stock, which may be noted between these financial statements and that stated in Mr. Meyer's letters of May 11 and May 16, arises from the fact that the Corporation apparently included as outstanding stock that which had been subscribed under Public No. 666, offsetting which there appears in the asset portion of the financial statement of April 30, 1931 (R. 288) an item of \$42,000 "due from purchasers of Class A preferred stock." This item, \$42,200, Mr. Meyer had not at that time included either as a capital liability or an accounts receivable asset. The financial statement of April 30 shows a total of \$105,150 outstanding stock, whereas Mr. Meyer considers only \$62,150 as outstanding stock, as he excluded that which was represented by

the accounts receivable from the purchasers (plus \$800.00 carried as treasury stock). On the basis of either statement there was an earned surplus of more than \$21,000; and as we have pointed out, there is nothing whatsoever in the examiner's report indicating that any asset was in April, 1931, worth less than its carrying value after the charge-offs above mentioned had been made.

This inclusion in the company's financial statements as outstanding capital stock of amounts subscribed but not yet paid for is in part the answer to the argument at pages 11-15 of appellee's brief that the capital stock of the company was not increased by the new subscriptions. The item "Due from purchasers of Class A preferred stock, \$42,200" in the April 30, 1931, statement (R. 288) had fallen to \$5000.00 in the October, 1931, statement (R. 295), and there was also an increase of \$8000.00 in the outstanding B stock between those two dates. The remainder of the answer to the argument of appellee just mentioned is the fact that the financial statements selected by the appellee for introduction in evidence did not embrace the entire period during which the company's subscriptions to stock and setting up of its changed capital situation on its books took place. The exhibits in this respect commenced

with the statement of March 31, 1931, after its stock subscription campaign had commenced, and ended with October. The company's letter to Mr. Burleigh was dated March 19, 1931 (R. 172), and doubtless the March 31 statement included as a part of the capital stock there shown (R. 287) some subscriptions already received and put upon the books, although the transactions were not closed. The minutes of the company's directors' meeting of January, 1932, introduced by appellee (R. 395), show that outstanding Class A preferred stock as of December 31, 1931, was 702 shares, or \$70,200, as compared with the \$50,000 shown on the books in the statement of October 31, 1931 (R. 295). Definitely the actual capital of the company was strengthened by full amount of the subscriptions when paid in.

Nor does appellee's argument or the finding (R. 105) that the Company bought in its stock at \$75.00 and sold it at \$100 fairly represent the transaction actually had. The minutes last referred to (R. 395) show that the holders of the 290 shares of Class A stock who turned their stock in to the company at \$75.00 per share in fact exchanged it for 217½ shares of Class B stock at par. This they were required to do (R. 390). Although it was called a sale of one kind of stock and purchase of another, it was, in fact,

merely an exchange of a 6% stock callable in two years for an 8% stock not callable for eight years (R. 274-5), the exchange being made on the basis of a full share of a 6% short term stock for 3/4 of one share of 8% stock which was not shortly callable. It is obvious that the stockholders who were making this exchange and who presumably were familiar with the affairs of the company had faith in the earning capacity of the company, as did its officers. That the expected result did not follow in due course was due to the violence of the subsequent decline in values hereinafter discussed.

The Court comments (R. 103) on other matters mentioned in Mr. Meyer's letter of May 11, including the loan of the Portland Livestock Company. The criticism of these loans is expressly based in the letter upon the fact that loans had been made to corporations in which officers of the corporation were interested, and other loans to relatives of officers of the corporation. The Portland Livestock loan of \$18,443.88 is shown by the examiner's marginal remarks to be secured by \$34,600 worth of property (R. 220); the Florence H. Curtis loan of \$1025.00 is shown to be secured by \$2500.00 in stock. The 45 Ranch Company is secured by sheep at a loan value of \$5.00 per head. This criticism by the bank was not and

could not have been based upon any lack of value in these assets. The Belle Curtice Wright loan does not appear at all in the list of loans criticized by the examiner.

The Court also comments on Mr. Meyer's criticism of loans which are in excess of the loan limit to any individual. It will be seen by comparison that the limit named is 50% of what Mr. Meyer at R. 93 states as the unimpaired capital. The regulations of the Farm Loan Board limited individual loans discounted to 50% of the paid-in and unimpaired capital and surplus of the rediscounting corporation (Appendix A, p. 40) and we have seen that real estate items are to be excluded from the "unimpaired capital." None of these criticisms shown at R. 94 and 95 and commented upon by the Court at R. 103 have any reference to the value of the security and can furnish no support for the Court's finding that the items were worth less than the amount at which they were carried.

In Mr. Matson's letter of December 4, 1931, commenting on the report of examination as of October 29, 1931, "unimpaired capital" is used in the same sense as in Mr. Meyer's letter; and his characterization of the Curtice Farms account as "worthless paper" (Appellee's br. p. 23) is obviously used in

the same sense. It was by no means worthless as is shown by the examiner's remarks. The item of \$11,365.28 so characterized is shown by the examiner's remarks (R. 238) to have been based upon hay and cattle valued at \$10,120, besides all necessary equipment for operation of the farm, and the \$24,000 item (\$22,000) is shown to have consisted of a mortgage for \$22,000 subject to a first mortgage of \$20,600 on property valued at \$50,000.

SUBSEQUENT EVENTS

A fair consideration of the report and letter we have just discussed, which is the only evidence in the record as to the then existing financial condition of the company, seems to us to clearly prove that the company's stock was worth at least its par value.

But the Court relied in his findings upon losses later developing. To argue that the stock of the company was worth less than par or that its officers or anyone else had reason to believe that it was worth less than par, is eminently unsound and ignores the changed economic conditions that immediately followed. Had conditions remained as they were when appellee's subscription was made, the company could, no doubt, have performed its agreement to retire the stock and pay the note within a reasonable time.

As we have seen, by its discounts, it was earning 3% per annum, on nearly \$700,000 worth of loans. Its officers' salaries are shown by the record to have been low. Prices of farm animals had depreciated during the preceding two years, but it was currently believed in April, 1931, that the depths had been reached. In Appendix B of this brief (p. 44) we quote from the "Agricultural Outlook for 1931, U. S. Department of Agriculture, Misc. Pub. No. 1080, February, 1931" together with excerpts from then current business publications, which show this to be true. But the optimism reflected by these comments was not justified by the event. Instead of being through the depression, agriculture was upon the verge of an unprecedented decline in values. Turning again to the index numbers of farm prices, cattle dropped from 114 in April, 1931, which was the low figure up to that time since 1924, to 83 in December of the same year, to 73 in June of the next year and to 60 in December, 1933. Sheep dropped from 94 in April, 1931, to 58 by October of the same year and to a low of 45 in October, 1932. Wool dropped from 85 in April, 1931 (the lowest since 1921) to 68 in October of that year, to 38 in July, 1932 (Index numbers taken from pages 70, 71 "Livestock Meats and Wool Market Statistics and related data 1938" published by Bureau of Agricultural Eco

nomics, May, 1939.) That these low prices continued over a period of years is common knowledge. As a further illustration, let us compare defendant's own statement of values made in April, 1931, as compared with his next statement made in September, 1932. His cattle ranging from \$40 to \$100 in April, 1931, had dropped in September, 1932, to valuations from \$15 to \$40. His sheep had dropped from \$8.00 per head to about half that amount. That a livestock lending agency carrying the volume of livestock loans carried by the Agricultural & Livestock Credit Corporation survived these years with losses no greater than those found by the Court, speaks well for the character of the loans held by it when his transaction took place in April, 1931, and proves more strongly than the examiner's report, convincing as it is, that the company's collateral was at that time in good condition.

We think no further argument is necessary to point out the impropriety of arguing, from subsequent losses under tremendously changed conditions, that the company's stock was in April, 1931, worth less than its par value or could have fairly been considered to be so. The record shows that the purpose of the act, that of enabling such a corporation to tide over the depression and to be of service

to agriculture, was accomplished in the case of the Agricultural & Livestock Credit Corporation. In spite of the unprecedented and unexpected years of disaster that immediately followed the strengthening of its capital structure, its stock is not now and never has been without value. In his amended answer (R. 43-44) the appellee alleges that the affairs of the Corporation have now improved to a point where the Corporation has or appears to have net assets sufficient above its liabilities to make good on its promise to retire the preferred stock sold to the defendant and others; and he introduced evidence tending to prove this allegation (R. 319). As a matter of fact, the company is and for years has been making progress and still enjoys the rediscount privilege with the Federal Intermediate Credit Bank. Assuming that their present loans discounted with the bank or carried by the Corporation without such discount will be paid in full by the borrowers (and there is no indication in the record that they will not), and assuming, which we think we may from the record, that the outstanding preferred stock remains at \$110,500 as it was in January, 1932 (R. 395), the \$87,000 excess collateral carried by the Credit Bank (R. 319) would alone give the preferred stock a present value of about 80 cents on the dollar. The record does not show what other free assets the company now has

If appellee can substantiate his claim that the company agreed with him to retire or repurchase his stock, it would seem that in a proper action he may enforce that agreement.

The argument in appellee's brief that he never received the proceeds of his loan is adequately answered by appellant's brief. It is appropriate here to call attention to the regulations of the Farm Loan Board (Appendix A, p. 42) providing that as to agricultural credit corporations set up to deal wholly or principally with the Intermediate Credit Bank, the bank may require the pledge of all or any part of the capital of the corporation as excess collateral on the entire line of credit.

CONCLUSION

What we have said regarding the company's representations relates to its statements as to the financial condition of the company, which were representations of fact. The appellee probably believed that the company's stock was worth par, as did the officers of the loan company, the Secretary of Agriculture, and the Federal Intermediate Credit Bank of Spokane. The predictions and promises as to profits, dividends, and retirement or repurchase of stock might create a contract liability on the part of the company enforceable as such in a proper action, but

are not such representations of fact that fraud could be predicated upon them (23 Am. Jur., Fraud and Deceit, Sec. 35). Even were it otherwise, it is impossible to believe that appellee relied on the company's predictions as to future dividends, retirement of stock and payment by the company of his note. He knew too much about the livestock business to be deceived by predictions of immediate profit. He is a prominent lawyer in his state. He had recently served as attorney for the Corporation (R. 329). He was himself engaged in the livestock business in a livestock country and knew the conditions then confronting agriculture generally and livestock loaning institutions in particular. It was common knowledge that all livestock operators must rely upon expected improvement in conditions in order to regain profitable operations. No doubt the appellee believed his investment reasonably safe and expected that the investment might be ultimately profitable, but we prefer to believe that he was not influenced by mere cupidity in the transaction. He may have desired to help a friend of 4 years' acquaintance (Appellee's brief, p. 6) through a supposedly temporary embarrassment, or he may have invested in the stock through a public spirited desire to assist the livestock industry which was vital to the interest of his community generally and equal

vital to the interests of a practicing lawyer in a small town in a livestock country.

The appellant in this case has in its brief not assumed the burden of proving the truth of the representations made by the officers of the Corporation in this transaction. Obviously it is not required to do so. The record utterly fails to show that it had any part in the sale of stock to appellee or was a party to or could be responsible for any representations made. We are not presenting this brief upon the theory that the appellant was called upon to negative the alleged falsity of the representations. We do, however, feel that upon the record in this case the Federal Intermediate Credit Bank of Spokane and the Government officials are entitled to be believed from the charge made against them in the District Court's opinion. It seems to us clear that the Court did not view the transaction as of the time when it occurred, having in mind only what was then known to Congress, to the Secretary of Agriculture, to the Agricultural Livestock & Credit Corporation, and to the appellee himself; but that, imputing to all parties concerned a prophetic power

with which men are not endowed and reading subsequent history into the picture, he has found fraud where none existed.

Respectfully submitted,

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APPENDIX A

EXCERPTS FROM CIRCULAR 15

“RULES AND REGULATIONS OF THE FEDERAL FARM LOAN BOARD TO MAY 20, 1925, IN MATTERS PERTAINING TO THE FEDERAL INTERMEDIATE CREDIT BANKS.”

* * * *

Section 209, agricultural credits act of 1923, provides “that the Federal Farm Loan Board is authorized to make such rules and regulations, not inconsistent with law, as it deems necessary for the efficient execution of the provisions of this title.” Pursuant to the provisions of said section the Federal Farm Loan Board has adopted and presents herein certain interpretations of the fact and rules and regulations promulgated for the government of the Federal intermediate credit banks (p. 12).

* * * *

The term “agricultural credit corporation” shall be held to mean a corporation organized under the laws of any State for the purpose of loaning money for agricultural purposes as herein defined, or for the raising, breeding, fattening, or marketing of livestock (p. 12).

* * * *

The financial institutions to which these regulations equally apply are those named in paragraph (a) of subsection (1) of section 202 of the agricultural credits act of 1923, and include State and National banks, savings banks, cooperative banks, trust companies, agricultural credit corporations, incorporated livestock loan companies, and any other Federal intermediate credit bank (p. 13).

* * * *

Where a note is secured by warehouse receipt representing readily marketable and non-perishable agricultural commodities, or chattel mortgages on livestock, the limit upon such individual loans shall be 50 per cent of the paid-in and unimpaired capital and surplus of such rediscounting corporation (p. 13).

* * * *

Amount.—An intermediate credit bank should not promise to rediscount for any institution any given number of times its capital stock. The act prescribes a maximum of ten times the unimpaired capital and surplus of livestock loan companies or agricultural credit corporations. The character of the notes at the time offered and the condition of the company afford a proper test whether it is entitled to the maximum permitted under the law or to rediscount any additional paper (p. 14).

* * * *

Non-liquid capital investment.—Investment of the capital of a rediscounting agency in stock of an industrial corporation, office building, long-term real estate loans, or other non-liquid securities restricts the ability of the rediscounting agency to indemnify the bank upon its indorsement liability. Where the capital of a rediscount agency is so invested, the banks should consider it as being impaired to such extent as may be disclosed by careful investigation (p. 14).

* * * *

Maturities.—No loan may under the act be made on paper acquired with a maturity of less than six months from the date of its acquisition by a Federal intermediate credit bank, and for the present no paper will be taken with a maturity longer than nine months, except for livestock loans, in which cases the maturities may not exceed one year. Renewals are left to the sound discretion of the intermediate credit bank, provided that no renewal shall be for a longer period than is permitted on the original loan (p. 16).

* * * *

Investments of capital stock.—A Federal intermediate credit bank may require the investment of the capital stock of an agricultural credit corporation in United States Government bonds, intermediate credit

bank debentures, Federal land bank bonds, or eligible farmers' paper. The intermediate credit bank shall determine which of these securities are acceptable from a particular agricultural credit corporation (p. 17).

* * * *

Pledge of additional collateral.—A Federal intermediate credit bank may require the pledge of additional collateral from any financial institution with which it does business. As to agricultural credit corporations set up to deal wholly or principally with the intermediate credit bank, it may require the pledge of all or any part of the capital of such corporation. This should be accompanied by a general collateral pledge agreement making such excess collateral, whether of capital or otherwise, fully available for all obligations of the agricultural credit corporation to the intermediate credit bank, through indorsement of rediscounts or otherwise (p. 17).

REGULATION OF APRIL 11, 1931

"TREASURY DEPARTMENT

Washington
April 11, 1931Federal Farm Loan Bureau
FICB 98
LB EXAM 158To All Federal Intermediate Credit Banks,
Land Bank Examiners

On April 9, 1931, the Federal Farm Loan Board adopted the following resolution:

'RESOLVED, pursuant to the authority conferred upon the Federal Farm Loan Board by the provisions of Title II of the Federal Farm Loan Act as amended, with respect to Federal intermediate credit banks, that the following regulation be and it is hereby adopted.

'Any Federal intermediate credit bank may discount in accordance with section 202 (a) (1)

of Title II of the Federal Farm Loan Act as amended any note or other obligation upon which the original borrower has been charged a rate of interest not more than three per centum per annum in excess of the discount rate of such bank at the time such loan was made, or may accept such note or other obligation as security for a loan or advance made pursuant to said section 202 (a) (1) as amended; provided that such rate of interest be not greater than that permitted by applicable state law and that such note or other obligation meet the requirements of said Title II and of the bank thereunder.'

Chester Morrill

Secretary and General Counsel"

APPENDIX B

The following quotations are taken from publications current at the time of the transaction involved in this case, and are submitted as reflecting the belief, then general, that livestock loans which could have been liquidated at the then current market prices would not involve loss to the creditor if the operators were permitted to continue in business:

From *The Agricultural Situation* (Bureau of Agricultural Economics, U. S. Department of Agriculture), February, 1931, page 8:

“The Beef Cattle Outlook—Cattle prices during the first half of 1931 are expected to average considerably below those of the first half of 1930 but prices during the second half will probably average about the same as those of a year earlier. . . . Consumer demand for beef probably will remain near present levels until there is a marked improvement in business conditions. The gradual upward trend in cattle production which has been under way since 1928 is expected to continue during the next few years. In view of probable *increase in demand during this period as a result of an improvement in industrial conditions* and a normal growth in population, moderate expansion does not seem undesirable.

From *The Agricultural Situation*, March, 1931, page 1:

“Well informed observers are now very conservative in their forecasts of the business situ

tion, although general opinion seems to favor *some improvement by the latter part of this year.*”

From “The Agricultural Outlook for 1931,” U. S. Department of Agriculture, Misc. Pub. No. 108, February, 1931:

Page 1—General Agricultural Outlook

“Farmers may reasonably expect somewhat lower production costs, a possible tendency toward improvement in market demand, and a greater degree of stability in general commodity prices during 1931.”

Page 2—

“... the livestock industries have such advantage as goes with relatively cheap grain. Wages of farm labor are the lowest in a decade. Fertilizer prices have declined. The condition of farm equipment and of the whole producing plant is fairly good. In general, agriculture stands to gain by the gradual stabilizing of business and prices.”

Page 17—Cattle Prices

“... During the second half of the year several conditions may develop which would tend to strengthen cattle prices. These are: (1) a marked scarcity of grain-fed steers; (2) improving consumer demand for beef because of increasing industrial activity, cooler temperatures than prevailed in July and August, 1930, and smaller supplies of fresh pork to compete with beef; and (3) a stronger feeder demand than prevailed a

year earlier as a result of fairly favorable returns from 1930-31 feeding operations and prospects of a much larger production of feed in 1931 than in 1930."

Page 74—Domestic Demand

"... it seems fairly certain that recovery will be in evidence during the latter half of 1931 continuing with greater momentum into 1932. With such developments, the demand for farm products during the crop season 1931-32 is likely to show a considerable improvement from the present unusually low levels."

Page 75—

"Although domestic demand is not likely to show any marked improvement during the first half of 1931, it seems reasonable to expect a business revival to become more evident during the last half of the year. Consequently farmers may anticipate that domestic demand conditions for farm products will be better during the 1931-32 marketing season than they have been throughout the 1930-31 season. But demand, although improved, will probably not be so good as that of 1929.

"With the gradual recovery in business strengthening in the level of wholesale prices may be anticipated. Should recovery in the country be accompanied by some improvement in business in other countries, it is probable that more of a recovery in prices may take place during the latter half of 1931 and in 1932. Agricultural prices under these conditions would share in the improved domestic and foreign demand."

Page 81—The Long-Time Outlook

“In the general advance in commodity prices that may be expected to accompany the prospective revival in business during the 1931-32 season, prices of farm products (like other raw materials) should normally advance more than the general index, particularly if agricultural production should not be generally increased this year.”

From Business Week's cover page forecasts. May 3, 1931:

“Ultimately and in the extreme application, the easy money invitation to business initiative will doubtless prove effective but ultimately also, the depression will disappear of itself. Pressure is needed to speed the process.”

From Business Week's cover page forecasts. May 10, 1931:

“The full effect of Federal Reserve effort to check chronic credit contraction and overcome commercial bank inertia and conservatism will not be seen for several months, but its pugnacious policy is pointed in the right direction and by every precedent, should speed recovery. Increasing stability in stocks and strength in bonds are already reassuring results.”

From the conservative Commercial and Financial Chronicle—June 27, 1931, page 4636. In speaking of President Hoover's moratorium on reparation payments:

“The disposition everywhere is to look upon the event as marking a turning point in the long period of depression in trade and business. What is more, a disposition has grown up to assist the President in making it a real turning point in the period of depression by cooperating with him to that end. The spirit of cooperation is everywhere in evidence.”